

## Your Guide to Backup Withholding

- (1) I'm confused about the payment/filing dates for backup withholding. [Idaho Income Tax Administrative Rule 877](#) states that the payment deadline is January 31; however, the [Form 65 instructions](#) list an April 15 (April 17 for 2012) deadline. Which is correct?

The deadlines are April 15 for calendar year filers and the 15th day of the fourth month following the end of the tax year for fiscal year filers.

- (2) Who isn't eligible to elect to have a qualifying pass-through entity pay the tax for officers, directors, owners, or beneficiaries?

The election isn't available to:

- Corporations,
- Partnerships,
- Electing small business trusts,
- Any other person who isn't an individual,
- A nonresident individual owner or beneficiary who has Idaho taxable income in addition to income for which the individual has made the election under Idaho Code section 63-3022L,
- Idaho resident individuals, or
- An Idaho part-year resident individual who has Idaho taxable income in addition to income from a pass-through entity.

- (3) What happens if the individual doesn't make the election?

If the individual doesn't make the election to have the entity pay the tax, the pass-through entity (PTE) must remit backup withholding on the individual's share of the PTE's income. This includes guaranteed payments and wages, salary, and other compensation paid by the PTE that's required to be included on the owner's Idaho return.

- (4) What should be included in the computation of Idaho taxable income for an electing individual?

The following items must be included:

- Compensation paid by the pass-through entity to the officer, director, owner, or beneficiary that is income from Idaho sources
- Pass-through items that are income from Idaho sources
- Distributable net income from an estate or trust that is income from Idaho sources

- (5) What deductions aren't allowed to be claimed by the pass-through entity paying the tax on behalf of an individual?

The following items aren't allowed:

- Capital loss
- Net operating loss (NOL)

- Idaho capital gains deduction
- Informational items
- Items not deductible under the Internal Revenue Code
- Items not reported as a pass-through deduction, including:
  - The standard deduction
  - Personal exemptions
  - Itemized deductions

(6) Are there any exceptions to withholding?

Yes. Backup withholding by a pass-through entity isn't required on the income of the following pass-through owners and beneficiaries:

- Owners and beneficiaries who aren't natural persons, including corporations, partnerships, trusts, and estates
- Unit holders of a publicly traded partnership as defined by Internal Revenue Code section 7404(b), if the publicly traded partnership:
  - Is treated as a partnership for purposes of the Internal Revenue Code; and
  - Has agreed to file an annual information return reporting the name, address, taxpayer identification number, and other information requested by the Tax Commission of each unit holder with a distributive share of partnership income in Idaho in excess of \$500 for the tax year
- Resident individuals
- Part-year individuals who have income other than from a pass-through entity
- Nonresident individuals if:
  - The individual elects to have his Idaho tax on income from the pass-through entity (PTE) reported and paid by the PTE
  - The individual's share of income, guaranteed payments, and compensation from the PTE from Idaho sources is less than \$1,000 for the tax year in which the income is subject to tax
  - The income is subject to withholding under Idaho Code section 63-3035 or 63-3036

(7) Is [Form PTE-WX](#) required for persons allocated less than \$1,000?

If the individual is a nonresident and the share of income from Idaho sources is less than \$1,000 for the tax year in which the income is subject to tax, no withholding is required and a PTE-WX wouldn't be needed.

(8) Is [Form PTE-WX](#) required for each resident partner to prevent the partnership from withholding and paying tax on income greater than \$1,000?

Withholding isn't required on income from a pass-through entity (PTE) of an individual owner or beneficiary who certifies to the PTE that he's an Idaho resident. The certification must be made on [Form PTE-WX](#). The PTE may rely on the certificate as evidence that distributions to such an individual are exempt from withholding unless the PTE knowingly accepts a false certificate.

- (9) If a trust pays income tax on behalf of a resident beneficiary, what is the correct way for the resident individual to report the income and tax paid on the individual return?

According to [Idaho Income Tax Administrative Rule 290.01b.v.](#), the election to have a qualifying pass-through entity pay the tax as provided in Idaho Code section 63-3022L, isn't available to Idaho resident individuals.

To remedy the situation, the trust should file an amended return asking for a refund of the taxes paid on behalf of the resident.

- (10) If a pass-through entity (PTE) doesn't make cash distributions to nonresident owners, is it still required to withhold tax on the owner's share of Idaho income?

A PTE transacting business in Idaho is required to withhold income tax on a nonresident individual's distributable Idaho source income (including guaranteed payments) and other Idaho source compensation, unless the nonresident elects to have the partnership pay the partner's tax on Idaho [Form 65](#). The nonresident partner makes the election on [Form PTE-WX](#) and provides this form to the PTE. This election can't be made by a nonresident individual partner who has Idaho taxable income from a source other than another PTE.

- (11) I can't find the penalty provisions that apply to a pass-through entity with nonresident beneficiaries if it chooses not to withhold Idaho tax of 7.8% on distributions of \$1,000 or more.

According to Idaho Code section 63-3036B(6), "amounts required to be withheld and paid over to the state tax commission under this section that are not withheld or paid over at the time and in the manner required by the provisions of this section shall be a deficiency in tax as defined in section 63-3044, Idaho Code." As such, it would be treated as any other deficiency in tax and would be subject to the penalties outlined in Idaho Code, sections 63-3046 and 63-3075.

- (12) If an S corporation stockholder has been regularly making Idaho estimated payments voluntarily or if a partner in a partnership is a corporation that already makes estimated payments, is the pass-through entity required to also pay the entire year's tax?

Yes. There's no provision in Idaho law that exempts the payment in this situation.

- (13) If a pass-through entity (PTE) has owners that have other businesses in Idaho with major losses, to the point that they know they'll owe NO Idaho tax, does the one PTE that is profitable still have to pay their tax?

Yes. There's no provision in Idaho law that exempts the payment in this situation.

- (14) If a partnership has \$30,000 of rental profits allocated to nonresident partners, but also has \$50,000 of investment interest expense allocated to nonresident partners, does the pass-through entity have to pay tax on the profit, despite the investment interest expense?

Yes. There's no provision in Idaho law that exempts the payment in this situation.

- (15) The [instructions for the new Form PTE-12](#) aren't clear about how to calculate the "income subject to withholding." Do we factor in Sec. 179 expense, charitable contributions, 2% misc. itemized, ID adjustments, etc.?

Yes. According to Idaho Code section 63-3036B(4), a pass-through entity (PTE) that's transacting business in Idaho is required to withhold tax on the individual's share of income from the PTE. According to Idaho Code section 63-3022L (2), that income includes:

- Wages, salary, and other compensation paid by the PTE to the extent it is Idaho taxable income of the individual
- The share of any income, loss, deduction, or credit of a PTE required to be included on the individual's Idaho return

- (16) Are the entities really required to obtain a Form PTE-WX from each resident member/shareholder?

The pass-through entity (PTE) should obtain Forms PTE-WX for resident and part-year resident individuals who claim they're exempt from withholding and nonresidents for whom the PTE is paying the tax on the pass-through owner's share of PTE income and compensation. As noted on [Form PTE-WX](#), the form should be retained by the PTE.

- (17) Is there an exception to the withholding requirement for nonresident partners of a multistate partnership that pay estimated Idaho income tax and file Idaho tax returns annually? Logic dictates that "backup withholding" is unnecessary since that tax due was voluntarily remitted by the nonresident individual partners.

There's currently no exception in the Idaho Code; however, the best solution would be to reduce the "estimated payment" by the amount withheld by the entity.

- (18) If nonresident individual partners elect for the pass-through entity (PTE) to pay tax on the partners' share of Idaho income, will they be unable to file Idaho income tax returns on which they'd report partnership income and take a credit for the PTE backup withholding?

This option isn't available on the 2011 tax return. These situations will be examined on a case-by-case basis.

- (19) I have a pass-through entity that will owe tax on behalf of its nonresident shareholders. We have to get an extension each year due to the complexity of the return because we operate in many states. When we file an extension, we have no idea how much tax should be deposited. Will we be penalized on this; is there a safe harbor?

The best solution in these situations is to make a good faith estimate. That estimate can be based on last year's distributable income.

- (20) The following scenario seems like it will be a common one during income tax filing season: a pass-through entity (PTE) files a return and [Form PTE-12](#) on 3/1/2012. The nonresident partner receives a [Form Idaho K-1](#) showing Idaho withholding and files an individual Idaho return on 3/15/2012. The PTE submits [Form PTE-01](#) on 4/17/2012. Will the individual's refund be held up because there's no record of the withholding payment until 4/17/2012?

We'll analyze these situations on a case-by-case basis. In the above situation, we'd match what the individual reports on the return with what the entity reported and determine if those amounts are consistent. If those amounts match and there aren't other issues with the return, the individual's refund could be processed.

- (21) I have nonresident shareholders in an Idaho S corporation. All income is from Idaho. If the shareholders pay estimated tax payments to the state of Idaho and file an Idaho nonresident return, are they still subject to the pass-through withholding?

There's no provision to exempt them from withholding. Nonresident shareholders must either have withholding taken out of the distributable income or have the income taxes paid at the entity level.

- (22) Can the taxpayer write a note on the bottom of [Form PTE-WX](#) promising to pay and relieve the tax preparer and entity of responsibility?

A properly completed PTE-WX must be on file to determine if the taxpayer elects to have the entity pay the tax or if income tax will be withheld from the distributable income, and:

- There's no provision for a "promise to file"
- Without a completed PTE-WX, the entity will default to withholding on the distributable income

- (23) Will the pass-through entity be penalized if the "estimated withholding" payment falls short based on actual distributable income?

As long as the estimated withholding is based on a reasonable estimate, the Tax Commission has determined that the issue would not be pursued; however, each situation will be examined on a case-by-case basis.

For more information, please email Cynthia Adrian, Tax Policy Specialist at: [Cynthia.adrian@tax.idaho.gov](mailto:Cynthia.adrian@tax.idaho.gov) or call her at (208) 334-7670.